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Fraud Risk Assessment and Prevention: Anatomy of Nonprofit Fraud

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Nearly 40% of financial management teams lack annual fraud prevention procedures, checklists, and similar reviews, according to the Church Financial Management Survey from the Evangelical Council for Financial Accountability (ECFA).

Anatomy of Nonprofit Fraud

- Cost?
- Schemes?
- Who? Why?
- How can you protect your organization?
- Case studies and examples
- Conclusions and recommendations

The Cost of Fraud

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Organization Type – Frequency

- Nonprofit organizations account for 10% of all fraud reported
- 22% of fraud cases occurred within organizations of 100 or fewer employees, with a median loss of $126,000
- $76,000 median loss in fraud cases at religious, charitable, or social services organizations

Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Median Loss Due to Fraud

- $69,000 in nonprofits
- $110,000 in government agencies
- $120,000 in private companies
- $140,000 in public companies
- As a percentage of total cash reserves, nonprofit losses are much higher and more damaging than those of public companies

Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Collusion Makes a Big Difference

Number of Perpetrators	Median Loss	Duration
One	$55,000	12 months
Two	$125,000	12 months
Three or more	$324,000	12 months

49% of fraud cases in the 2026 ACFE report involved two or more perpetrators.

Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Additional Thoughts to Consider

- Approximately 80% of church fraud is never reported
- Church financial fraud worldwide was predicted to hit $80 billion by 2025
- What could churches do with $80 billion?

Source: “Fraud Against Churches Exceeds What Churches Give to Missions,” Brotherhood Mutual

How Fraud is Committed

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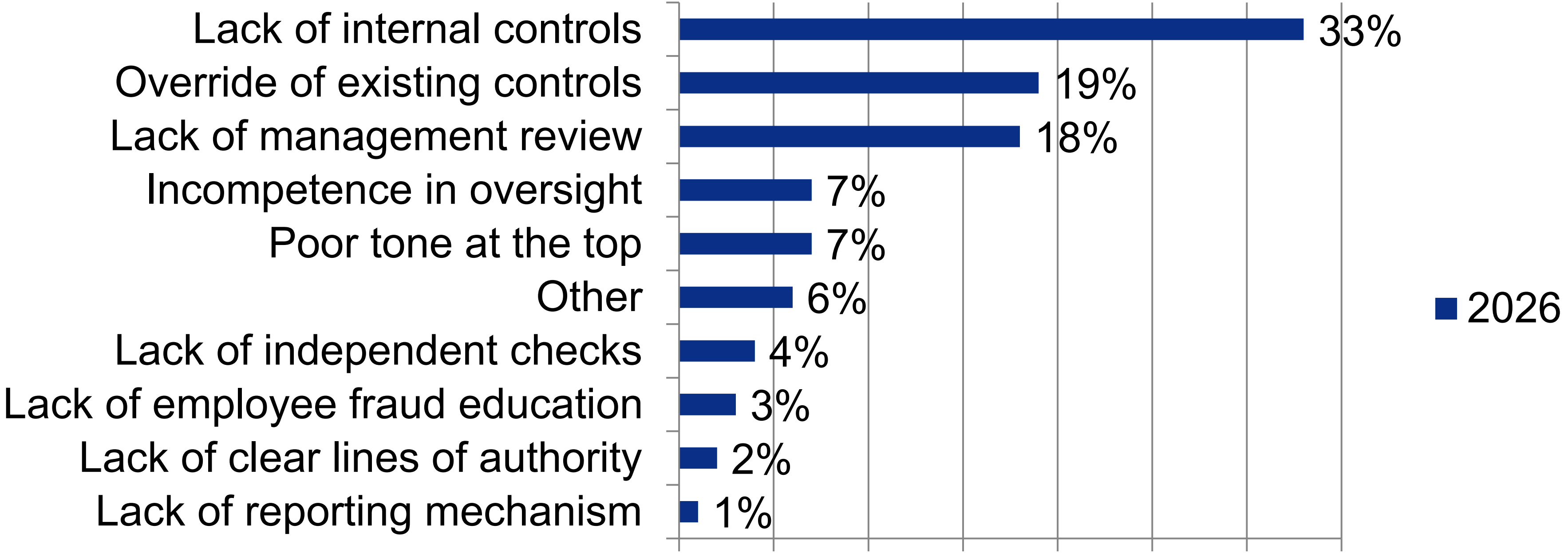
Asset Misappropriation: Most Prevalent Fraud Scheme

Scheme	Percent of Cases	Median Loss
Noncash	23%	$75,000
Billing	21%	$90,000
Expense reimbursements	13%	$36,000
Check and payment tampering	10%	$114,000
Cash on hand	10%	$20,000
Payroll	10%	$63,000
Skimming	9%	$45,000
Cash larceny	8%	$45,000
Register disbursements	3%	$14,000

Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Primary Internal Control Weaknesses



Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Profile of a Fraudster

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Perpetrator Profiles

Most Common

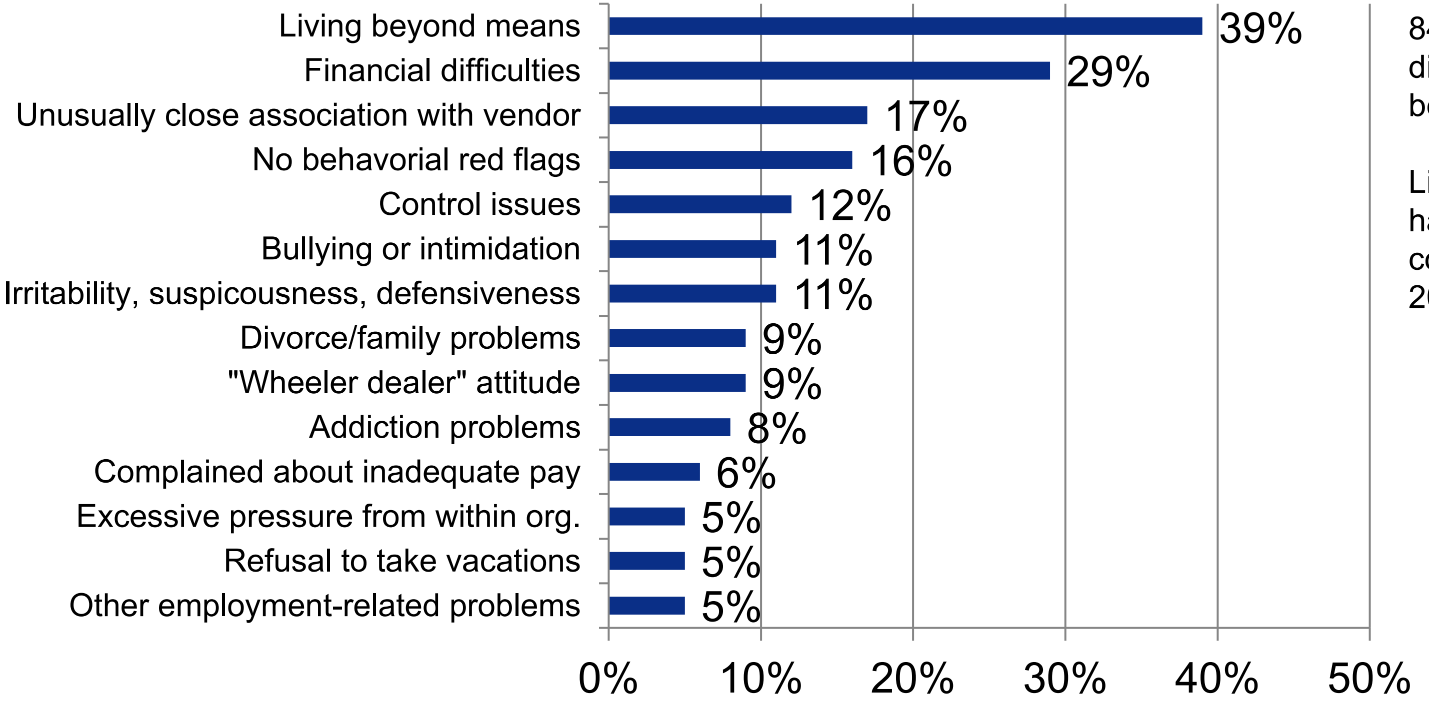
- 71% of fraudsters were male
- Over two-thirds were 31 – 50 years old
- 85% were never previously charged or convicted of fraud
- The longer the perpetrator has worked for an organization, the more costly their fraud

Most Costly

- Male – median loss of $125,000
- Age 60+ – median loss of $850,000
- Owner/executive – median loss of $475,000

Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Behavioral Red Flags Displayed by Perpetrators



84% of fraudsters displayed at least one behavioral red flag.

Living beyond their means has been the most common red flag since 2008.

Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Fraud Prevention

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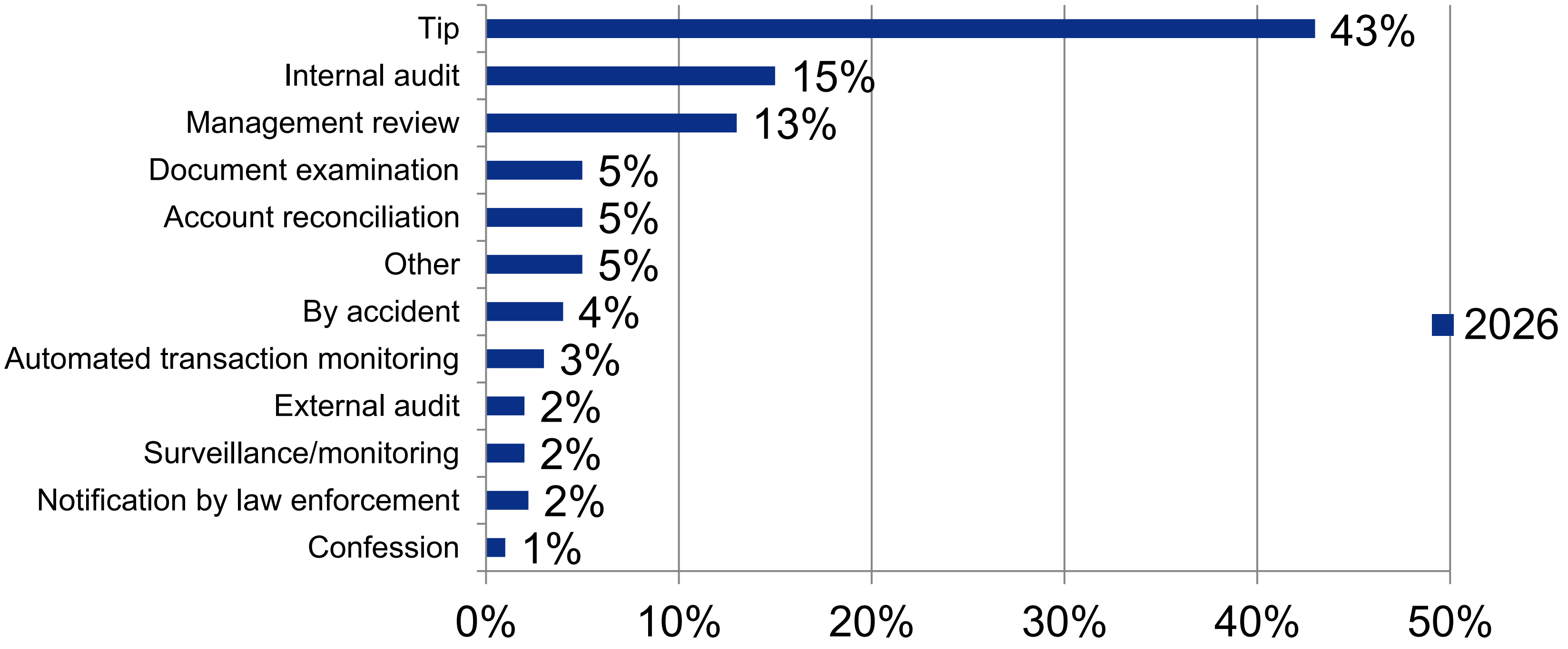
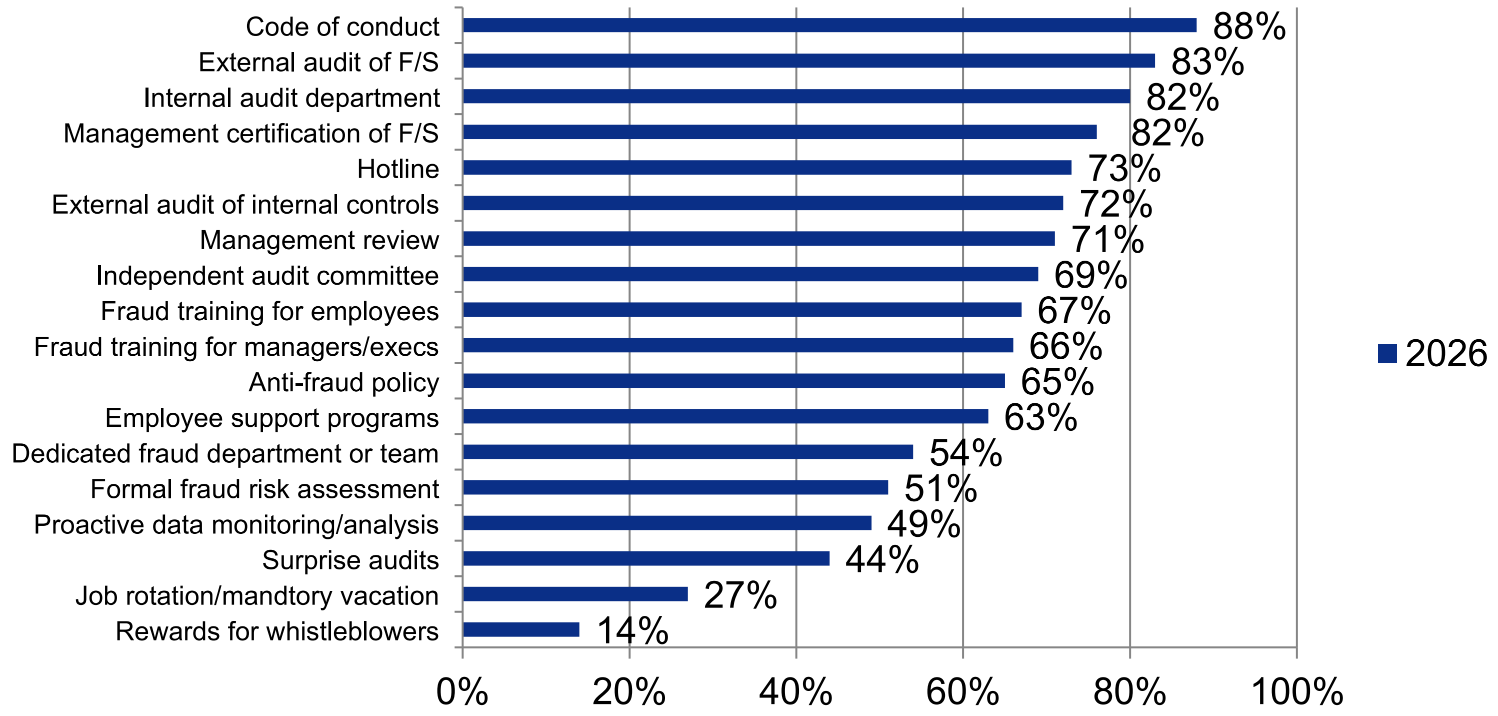
Percent of Cases Detected by Method



Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Anti-Fraud Controls Used



Source: *Occupational Fraud 2026: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

Case Studies & Examples

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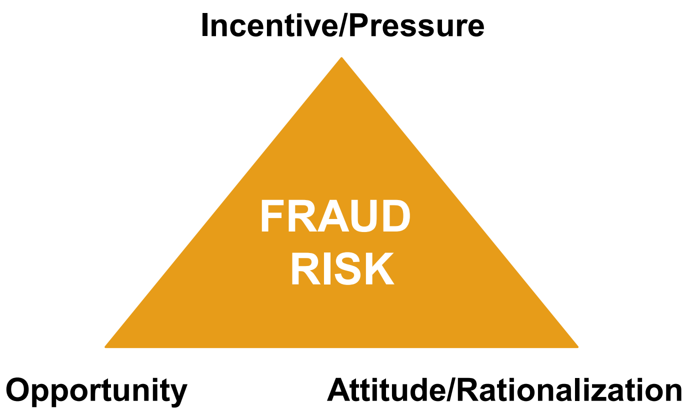
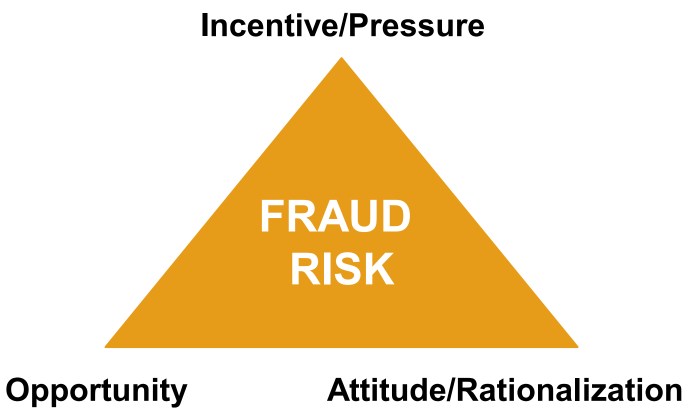
Case Study – HR Director

- **Incentive** = Lavish lifestyle
- **Opportunity** =
  - Lack of timely bank reconciliations
  - Unsecured check stock
  - Management override
  - Methods:
    - Ghost employees/terminated employees
    - Insurance premium payments to personal account
    - Related-party vendors
- **Rationalization** = No one will notice



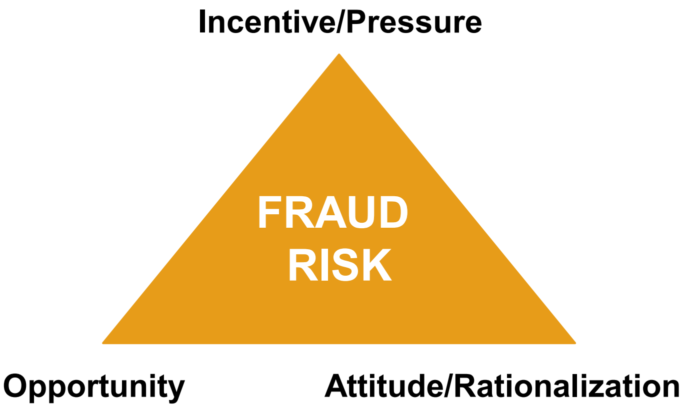
Case Study – Executive Pastor

- **Incentive** = Gambling addiction
- **Opportunity** =
  - Lack of segregation of duties
  - Methods:
    - Skimming cash – preschool tuition, wedding deposits, etc.
    - Unauthorized credit card charges
    - False mileage reimbursements
    - Checks payable to self or cash
    - Direct deposits from HRA to personal account
- **Rationalization** = Will pay back the money



Case Study – IT Director

- **Incentive** = Supplemental income
- **Opportunity** =
  - Inadequate supervision by CFO
  - No review of new vendors
  - Methods:
    - Purchasing IT equipment from his own business
    - Purchasing/selling extra IT equipment for additional personal profit
    - Unauthorized credit card charges
    - Expense reimbursements with inadequate/illegitimate business purpose documentation
- **Rationalization** = Underpaid and the church was using "most" of the equipment



New Church Risks

- No longer just physical fraud
- Uptick in cyber fraud and electronic-type fraud
- Due to the trusting environment at churches, particularly toward assisting in times of need

Top Church Fraud Risks to Consider

- Cyber Fraud
  - Social engineering
  - Ransomware
- Internal Fraud
  - Asset misappropriation
  - Corruption
  - Payroll fraud

Cyber Fraud: Social Engineering

- The art of manipulating people to give up confidential information
- Targeting susceptible individuals to share sensitive information such as:
  - Passwords
  - Bank information
  - Computer access
- Easy to exploit the natural inclination to trust
  - Easier to fool someone to provide a password than to try to hack it

Types of Social Engineering

- Phishing – Sending emails acting as a reputable company/ individual to persuade the recipient to reveal personal information
  - Email from a trusted friend
    - Contains a link or a download of an attachment
  - Email from a trusted source
    - Financial institutions
    - Notification of a breach and to “verify information”

Phishing, continued

- Emails with compelling story or pretext
  - Posing as your boss, coworker, etc.
  - Urgent request for help
  - Donation to charitable fundraiser
  - Notification that you have won a grant or large donation and asking you to verify information by clicking on the link provided

Ransomware

- Malware that employs encryption to hold a victim's information for ransom
- Encrypts an organization's database to restrict access
  - A ransom is demanded to provide access
- Usually distributed through spam or targeted attacks
- Never a guarantee that the recovered data is not compromised

Internal Fraud – Asset Misappropriation

- Occurs when people who are entrusted to manage the assets of an organization steal from it
- Typically, cash or cash equivalents are stolen
  - Fake invoicing
  - Skimming
  - False expense reimbursements
- Common in church fraud due to recurring theme: lack of segregation of duties

Internal Fraud – Corruption

- Dishonest behavior by those in positions of power
    - Pastor/ministerial staff
    - Committee/elders
    - Those in a decision-making capacity
- Abusing one's influence and power for personal benefit
- Conflicts of interest and lack of disclosure

Internal Fraud – Payroll Fraud

- Phantom employee
  - Employee terminated, but supervisor continues to submit hours and obtain terminated employee’s checks
  - Fake employee added to register
- Payroll manipulation
  - Person with access to payroll register makes updates to their rates or the rates of others without supervision
- Lack of oversight and review

Conclusions and Recommendations

- DO implement an anonymous tip line and whistleblower policy
- DO review credit card statements, canceled checks, and bank reconciliations
- DO implement fraud training
- DO increase the perception of detection
- DON'T rely upon your external audit*
- DON'T use trust as an internal control
- DO assess your organization's vulnerability to fraud
- DO understand your fiduciary responsibility
  perlmanandperlman.com/embezzlement-board-liability

Protecting Your Church

Knowledge is Power!

- Educate church leaders and staff about risks and prevention
- Focus on controls
- Use technology as a tool

Educate Church Leaders and Staff

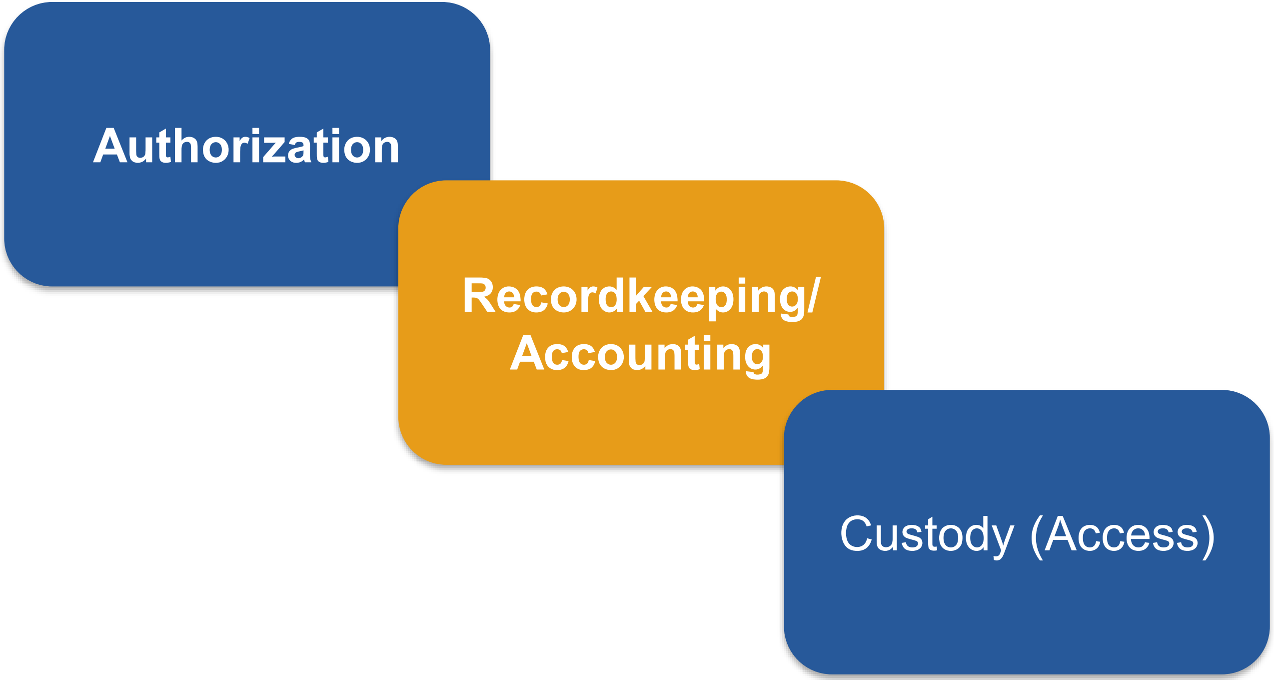
- Teach church leaders and staff about the risks of fraud and what to be mindful of
- Regularly test staff and leaders to keep awareness heightened
- Encourage a culture of fraud awareness among staff
- Adopt, and rigorously implement, a zero-tolerance policy towards employee fraud
- Develop and implement a clear response plan in case fraud is discovered

Focus on Controls

- Implement clear segregation of duties
  - Consider outsourcing some areas
- Implement a Whistleblower Policy
- Regularly perform bank and account reconciliations
- Clearly define review and authorization levels for payments
- Trust but verify

Key Internal Control Considerations

Segregation of Duties



Technology as Your Tool

- Restrict and closely monitor access to sensitive information and systems
- Adjust email spam filters
- Secure computing and technology devices
    - Anti-virus software
    - Firewalls
    - Email filters
    - Update operating systems regularly

Baseline Understanding of Controls

Internal controls fail for three primary reasons:

1. They were not designed properly
2. They were designed well but the people, processes, or technology changed
3. They may be designed well but not implemented effectively

Control Activities & Segregation of Duties

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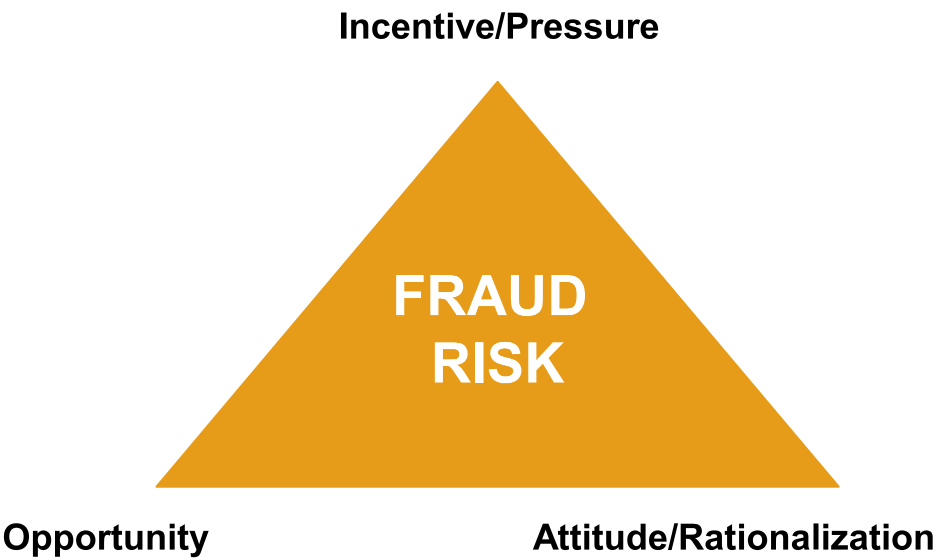
The Fraud Triangle



Segregation of Duties – Overall Concept

- The important thing to remember with all functions is that there should be separation between custody, authorization, and record keeping. Someone can do two functions, but not all three.
- Consider how this relates to your ministry and what areas may not have these functions handled by different individuals. Even with a small staff, this can be accomplished if you pay particular attention and make use of a variety of individuals, including volunteers.

Handling Business Expenses/Credit Cards

- Accountable Reimbursement Plan Rules
  - Business purpose (who, what, when, where, why?)
  - Timely submission of receipts (within 60 days)
  - Return excess amounts advanced timely
- Supervisory approval

Cash Receipting Process

- General steps to segregate in the cash receipts process (a - authorization, r - record keeping, c - custody):
  - Receiving funds/preparing a count sheet – two people present (c)
  - Preparing the deposit slip (r)
  - Making the deposit (c)
  - Entering in the subsidiary ledger (r)
  - Reconciling the count sheet with donor system and deposit slip (a)

Cash Disbursements Process

- General steps to segregate in the cash disbursements process (a - authorization, r - record keeping, c - custody):
  - New vendor approval process (a)
  - Approving invoices for payment (a)
  - Inputting invoices in the subsidiary ledger (r)
  - Check stock access (c)
  - Signature stamp access (c)
  - Writing checks (c)
  - Signing checks (a)
  - Mailing checks (c)
  - Dual controls over wires/ACHs (a)

Payroll Process

- General steps to segregate in the payroll process (a - authorization, r - record keeping, c - custody):
  - Approving new hires, salary and wage rates, bonuses, and terminations (a)
  - Approving time reports (a)
  - Entering payroll information (r)
  - Approval of hours by a supervisor (a)
  - Review of the pre- and final payroll registers by someone not involved in the process (a)

Information Technology

- We need to remember that while information technology isn’t directly related to the financial statements, it significantly impacts the processing.
- If proper controls are not established in this area, ministries are at risk in many areas.
- Employees could have access to software that would negate our segregation of duties, we could lose days or more of data, or we could have downtime that would lead to serious inefficiencies.

Other Areas

- Petty cash – Have someone independent of the custody of petty cash reconcile or “surprise” audit the account periodically.
- Inventory – This functions just like cash. Beware! Two people should sign off on counts and surprise inventories should be performed on a periodic basis.
- Journal entries can impact any area of the financial statements and should be reviewed by someone other than the preparer for accuracy and appropriateness.

Other Areas

- Bank reconciliations need to be completed and reviewed monthly by different individuals to provide a key control.
- Budget versus actual financial statement comparisons provide additional controls over inappropriate expenditures or incorrect coding. Individual department managers should be held accountable for their budgets and therefore review and approve the amounts in their line items on a consistent basis.
- Reconcile GL accounts to ensure proper coding of expenses
- Reconcile other balance sheet accounts (PPE, debt, receivables, payables, net assets, etc.)

Financial Reporting/Internal "Audit"

- If no requirement for an audit…
  - Best practice = independent review of processes and controls annually
  - Enlist the help of a qualified volunteer within the church or hire a CPA firm
  - Test/review sample of transactions for proper approval, supporting documentation, reasonableness, adherence to church policies
    - Credit card purchases, check and electronic payments, journal entries, deposits, bank reconciliations

General Comments

- Documentation is key — if it isn’t documented, there is no proof that it was done. Here are two documentation examples:
  - When reconciliations are performed or reviewed, the reviewer should initial to provide evidence that the step was completed.
  - All processes and procedures should be in writing and updated consistently.

Questions or comments?

Thank you!

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